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In The

Supreme Court of the United States

October Term, 1998

HARVILL E. WELLER, JR. and
FREDERICK B. WOOKEY, JR.,

Petitioners,

v.

DELOITTE & TOUCHE,

Respondent.

**On Petition For Writ Of Certiorari
To The Texas Supreme Court
And The Amarillo Court Of Appeals**

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

This case presents the question of whether the Due Process Clause of the Fourteenth Amendment prohibits an elected state judiciary from functioning as a legislature and retroactively shortening a limitations period to bar a pending lawsuit despite the existence of thirty years of established jurisprudence under which the suit was timely filed.

LIST OF PARTIES

Petitioners are Harvill E. Weller, Jr. and Frederick B. Wookey, Jr., on behalf of the Plaintiff Class.

Respondent is Deloitte & Touche.

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OPINIONS BELOW

The first opinion of the Amarillo Court of Appeals is unreported. Apx. 1. The second opinion of the Amarillo Court of Appeals on rehearing is reported at 976 S.W.2d 212. Apx. 2. The opinion of the Texas Supreme Court denying Petitioners' Petition for Review is unreported, as is the denial of the Petitioners' Motion for Rehearing of same. Apx. 3 and 4.

JURISDICTION

The Amarillo Court of Appeals entered judgment in favor of Respondent on April 14, 1998. The Texas Supreme Court denied Petitioners' Petition for Review on October 29, 1998 and denied Petitioners' timely Motion for Rehearing on January 7, 1999. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1257.

CONSTITUTIONAL PROVISION INVOLVED

This appeal involves the application of the Due Process Clause of the Fourteenth Amendment of the United States Constitution.

> [N]or shall any State deprive any person of life, liberty, or property, without due process of law.

U.S. CONSTITUTION, AMENDMENT XIV.

STATEMENT OF THE CASE

This is an appeal from a jury trial in which Petitioners obtained a $79 million judgment against Respondent for accounting malpractice and gross negligence.

Petitioners are a class of limited partner investors in Granada 4 ("Granada"), a Texas limited partnership formed to engage in agriculture and food production. Granada was supposed to buy cattle, graze them at pasture during tax year 1986, and pass the pasturage expenses on to the limited partners as tax deductions. This would enable the limited partners to lawfully deduct the amount of Granada's pasturage expenses from their 1986 tax returns.

Respondent, Granada's accountant and auditor, prepared Granada's tax return. During a "cold review" of Respondent's work, Respondent discovered that Granada had *absolutely no records* to support Granada's claimed $95 million pasturage expense, much less to support its position that it owned 800,000 cows during calendar year 1986. In fact, Granada bought and sold cows at feedlots on the same day, thus incurring no pasturage expense during the year. Respondent knew that the absence of records "could literally wipe out the deductions for the [limited partners]." Nevertheless, Respondent approved a $95 million deduction based upon pasturage of 800,000 cows.

The IRS challenged the pasturage expense deduction after easily confirming that it was unsupported. When confronted by the IRS, Granada's tax lawyer feared that the bogus pasturage deduction would trigger over $200

million in penalties. Without any prior notice to Petitioners, Granada secretly settled with the IRS for assessments against Petitioners totaling $79 million in back-taxes and over $20 million in penalty interest.

Petitioners first learned about the Granada 4 partnership's potential tax problems when they received a Final Partnership Administrative Adjustment ("FPAA"), which had been mailed by the IRS to Granada's general partner, Granada Management Corporation ("GMC") on May 7, 1990, and in turn mailed by GMC to Petitioners on May 30, 1990. Petitioners filed suit less than two years later on May 26, 1992.

At trial, Petitioners were awarded $20,370,443.24 in actual damages and $58,560,000.00 in punitive damages for gross negligence against Respondent. Respondent appealed the judgment arguing, *inter alia*, that the two year statute of limitations did not run from the date the Petitioners were assessed by the IRS or even from the date they received the FPAA from GMC, but from the earlier date when GMC received the FPAA from the IRS.

On September 16, 1997, the Amarillo Court of Appeals held that Petitioners' suit – which was brought within two years of the date the Petitioners were assessed by the IRS and within two years of their actual knowledge of *any* problem with their returns – was filed timely. In so holding, the court relied upon thirty years of Texas law established by the Texas Supreme Court in *Atkins v. Crosland*, 417 S.W.2d 150 (Tex. 1967), wherein the court held:

> the plaintiff's cause of action did not arise until the tax deficiency was assessed by the Commissioner of Internal Revenue. Prior to assessment

> the Plaintiff had not been injured. That is, assessment was the factor essential to consummate the wrong – only then was the tort complained of completed. If a deficiency had never been assessed, the plaintiff would not have been harmed and therefore would have had no cause of action.

Id. at 153. When it was filed, there simply was no controversy under well-established Texas law that Petitioners' suit was timely.

On December 11, 1997, the newly elected and reconfigured Texas Supreme Court usurped the role of the legislature and changed the law by shortening the limitations period for accounting malpractice cases. *See Murphy v. Campbell*, 964 S.W.2d 265 (Tex. 1997). To make matters worse for plaintiffs injured by accounting malpractice, the new limitations rule was applied retroactively to bar suits that the litigants had filed in reliance on *Atkins* and its progeny.[1] On December 22, 1997, Respondent moved the Amarillo Court of Appeals to reconsider its limitations argument in light of the *Murphy* opinion. On April 14, 1998, the Amarillo court changed its initial ruling and barred Petitioners' suit by retroactively applying the new law established in *Murphy*, despite its recognition of the "fundamental [un]fairness" of the result.

The federal question sought to be reviewed was raised in the Texas Supreme Court by a motion for

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[1] Curiously, Respondent was also the accountant held liable in *Murphy* and was the party which successfully argued for the new, shorter limitations period before the reconfigured Texas Supreme Court.

rehearing filed on November 11, 1998. Apx. 5. The Texas Supreme Court denied Petitioners' motion for rehearing on January 7, 1999. Apx. 4.

REASONS FOR GRANTING THE WRIT

The Texas Supreme Court and the Amarillo Court of Appeals denied Petitioners' right of due process under the Fourteenth Amendment by usurping the legislative role, creating a new, shorter limitations period and applying it retroactively to bar lawsuits that were timely under the old law. The applicable federal constitutional test was enunciated by this Court in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). This test was acknowledged and adopted in Texas by *Carrollton-Farmers Branch Indep. School Dist. v. Edgewood Indep. School Dist.*, 826 S.W.2d 489, 518-19 (Tex. 1992). As this Honorable Court has recognized:

> [J]udge-made rules of law are hard facts on which people must rely in making decisions and in shaping their conduct. This fact of legal life underpins our modern decisions recognizing a doctrine of nonretroactivity.

Lemon v. Kurtzman, 411 U.S. 192, 199 (1973) (citing *Chevron Oil*). This doctrine of nonretroactivity is grounded upon the Due Process Clause of the United States Constitution. As this Court explained in *Lampf, Pleva, Lipkind, Prupris & Petgrow v. Gilbertson*, 501 U.S. 350, 370-71 (1991), "*Chevron Oil* . . . reflect[s] a straightforward application of an earlier line of cases holding that it violates due process to apply a limitations period retroactively and thereby deprive a party arbitrarily of a right to be heard in court."

The non-retroactivity principle, grounded upon the Due Process Clause, is an important piece of federal jurisprudence established by this Court. The decisions of the Texas Supreme Court and the Amarillo Court of Appeals directly conflict with this established federal jurisprudence.

Petitioners should not be penalized for their reliance on what was at the time unequivocal, well-settled law and, therefore, respectfully request that this Court order that the Texas courts' retroactive application of the new rule announced in *Murphy* is unconstitutional.

CONCLUSION

For the foregoing reasons, this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX 1

NO. 07-96-0324-CV

IN THE COURT OF APPEALS

FOR THE SEVENTH DISTRICT OF TEXAS

AT AMARILLO
PANEL D

SEPTEMBER 16, 1997

DELOITTE & TOUCHE, APPELLANTS

V.

HARVILL E. WELLER, JR. AND
FREDERICK B. WOOKEY, JR., APPELLEES

FROM THE 234TH DISTRICT COURT
OF HARRIS COUNTY;

NO. 92-023452;
HONORABLE SCOTT A. BRISTER, JUDGE

Before BOYD, C.J., and QUINN and REAVIS, JJ.

This appeal arises from a class action brought by limited partner investors in Granada 4, a Texas limited partnership formed to engage in agriculture and food production. Harvill E. Weller, Jr. and Frederick B. Wookey, Jr. are the representative members of the appellee class. The suit was brought against appellant Deloitte & Touche (Deloitte) for alleged negligence in preparing the partnership's tax return. In 15 points, Deloitte contends the trial court erred in rendering judgment against it for interest paid on back taxes to the Internal Revenue Service and for exemplary damages. For reasons we later

express, we reverse the judgment of the trial court and remand the cause to that court.

A proper consideration of Deloitte's challenges requires us to recount the rather complicated factual and procedural history of this dispute. In 1986, the Granada 4 limited partnership consisted of 10, 358 limited partners and one general partner, Granada Management Corporation (GMC). Granada 4 was designed and operated as a registered tax shelter for the limited partners. The partnership obtained tax benefits deferring and converting ordinary income into capital gains by investing in joint ventures involving agriculture. Several of these joint ventures were with other limited partnerships formed by GMC.

On of the joint ventures in which Granada 4 invested in 1986 involved the purchase of 800,000 cattle to graze on land leased by the partnership. The objective was to permit the partnership, and consequently the partners, to take a deduction for the cast of keeping the cattle at pasture. This deduction is referred to as the pasturage deduction. At the end of 1986, GMC hired Deloitte to prepare and sign the partnership's 1986 tax return. That return included a 95 million dollar pasturage deduction. It was signed by Deloitte partner Ben Anderson.[1] Based on information provided to them in K-1 forms sent out by GMC, the limited partners took deductions on their individual returns in proportion to their investment in the partnership.

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[1] Anderson also signed the returns of the joint ventures in which Granada 4 invested.

The Internal Revenue Service (IRS) subsequently audited the 1986 returns of Granada 4 and the joint ventures in which it had invested. As a result of the audits, the IRS disallowed numerous deductions taken by these entities. The disallowed deduction that is the primary focus of this litigation is the pasturage deduction. The IRS determined that there was no, or at least inadequate, evidence showing that the joint ventures owned cattle at pasture in 1986. On April 10, 1990, the IRS sent notices of deficiency, each entitled Final Partnership Administrative Adjustment (FPAA) to three of the joint ventures. A corresponding notice was sent to Granada 4 the following month. GMC informed the limited partners of the FPAA and GMC's challenge thereto on May 30, 1990.

On November 15, 1991, GMC entered into three settlement agreements with the IRS, one for each of the joint ventures whose deductions were disallowed. The disallowed deductions totaled 79 million dollars. The pasturage deductions accounted for only a portion of this amount but, appellees contend, the partnership's position was so weak on that issue that it was forced into a settlement. Because the settlements avoided the imposition of substantial penalties by the IRS, there is no dispute whether the settlements were appropriate.

The IRS assessed back taxes and interest against the limited partners. Because the transactions at issue were tax motivated, the agency applied former section 6621(c) of the Internal Revenue Code in computing the interest

due by many of the limited partners. That section provided that "interest on substantial underpayments[2] attributable to tax motivated transaction . . . shall be 120 percent of the underpayment rate established under this section." 26 U.S.C. 6621(c) (1988) (repealed by Pub. L. 101-239, sec. 7721(b), Dec. 19, 1989, 103 Stat. 2399).

Appellees Harvell E. Weller, Jr. and Frederick B. Wookey, Jr., acting as representative members of a class consisting of all the limited partners in the Granada 4 limited partnership, filed suit against Deloitte on May 26, 1992. In the suit, appellees claimed Deloitte was negligent and grossly negligent in the preparation of the partnership's 1986 tax return by failing to investigate the basis for the deductions asserted by the partnership. They further alleged that Deloitte knew there were no records supporting the pasturage deduction before it signed the 1986 tax return and that it attempted to conceal this fact by generating false documentary evidence showing that the partnership had cattle at pasture when in fact it did not. In the suit, appellees sought actual damages "consisting of interest and tax-motivated or penalty interest," of over 34 million dollars, exemplary damages and pre and post-judgment interest.

Over the ensuing year and a half, the trial court discussed with the parties what procedures the court might employ in an effort to resolve the various issues in the action in the most efficient manner. The content of these discussions will be set out in greater detail as they relate to individual points of error. One significant event

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[2] An underpayment was "substantial" if it exceeded $1,000.

on this issue was Deloitte's October 22, 1993 motion, seeking to decertify the class as to "all issues of actual and exemplary damages, offset and credit for value of the use of the funds" and that these issues be tried individually for each member of the class in a non-jury proceeding. The parties have not identified where this motion was overruled, but in a later hearing, Deloitte asserted without contradiction that it had been overruled. Subsequent events support this assertion. The trial court did, however, ultimately decide to conduct a jury trial on the issues of liability and exemplary damages, reserving the question of actual damages for a subsequent proceeding. The primary reason expressed by the trial court for this approach was to avoid expending the time and money necessary to determine actual damages for the 10,358 class members if there was no liability.

The parties went to trial on these issues on October 26, 1993. On November 1, 1993, the jury returned a verdict finding Deloitte and the "Granada Entities"[3] negligent, that their negligence proximately caused "the occurrence in question," and assigning 60 percent responsibility to Deloitte and 40 percent to the Granada entities. The jury also found Deloitte's negligence to be gross negligence and awarded $77,685,000 in exemplary damages. Notwithstanding the fact that the issue of actual damages had not been determined, appellees moved for judgment on the verdict, which was denied. *See Travelers*

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[3] These were defined to include GMC, Granada Cattle Services, Inc., Granada Corporation, Inc., the Granada 4 partnership, and their agents, employees, officers, and directors.

Indemnity Co. v. Fuller, 892 S.W.2d 848, 852 (Tex. 1995) (holding there can be no exemplary damages without an award of actual damages).

After the trial, several additional discussions took place between the parties and the trial court on resolving the remaining issues. Deloitte contended that maintaining the class for damage determination was not appropriate because common issues no longer predominated over individual ones. In the alternative, it objected to the appointment of a special master to determine the facts relevant to actual damages because the expense of a special master would be taxed to it as costs. The trial court agreed to a claims procedure advocated by appellees. Under the plan, appellees would bear the expense of notifying the class members, collect documentation of the amount of interest assessed by the IRS, total the results and present this information to the court. The trial court suggested that the question of actual damages be resolved by "something that looks like a summary judgment proceeding" so that an appellate court would know how to analyze it.

On September 26, 1994, appellees filed their motion for summary judgment on the issue of actual damages. A total of 7,808 class members responded to appellees' request to submit claims. These class members submitted affidavits, evidence of the IRS assessments against them, and evidence of payment of the assessments. This evidence, comprising of approximately 110,000 pages of documents, was submitted in support of appellees' motion. Deloitte responded, asserting that questions of material fact existed as to individual members on several issues,

including mitigation and offset for class members' use of the money.

Throughout the trial and post-trial proceedings, the trial court did not rule on what portion of the interest assessed by the IRS was recoverable by the plaintiffs. In that connection, appellees sought recovery of all interest assessed by the IRS while Deloitte urged that the class members' use of the money more than offset any interest charged by the IRS. Alternatively, Deloitte argued that even if the extra interest charged by the IRS because the transaction was tax motivated was recoverable, the "ordinary interest" set out by Section 6621(a) of the Tax Code was not recoverable.

On December 13, 1994, the trial court sent a letter to the parties setting out its intended disposition of the remaining issues. On January 27, 1995, the trial court granted appellees' motion for partial summary judgment on actual damages and also rendered a final judgment in the suit. In its partial summary judgment order, the trial court found the "measure of actual damages in this case is the amount of interest assessed by the Internal Revenue Service and paid by the individual class members," that the amount paid by the 7,808 class members who submitted claims was $20,370,443.24, of which $17,060,469.85 was attributable to the ordinary IRS underpayment interest rate and $3,309,973.39 was "attributable to the tax-motivated 20% penalty."

In his final judgment, the trial judge included findings that the damages suffered by each class member "is equal to the amount of interest assessed by the [I.R.S.] and paid by the individual class members who have

timely responded with approved claims by December 29, 1994"; approved the accounting of these claims by an accountant hired by appellees; that the aggregate amount of those damages was $20,370,443.24; that Deloitte was entitled to an offset of 20 percent for Granada's negligence pursuant to Section 33.012(b)(2) of the Civil Practice and Remedies Code, making the total amount of damages $16,296,354.63; that appellees were entitled to prejudgment interest of $4,154,601.10; that there would be a remittitur of exemplary damages in proportion to the number of class members who did not submit claims, which would reduce the total exemplary damages to $58,560,000. The court then rendered judgment against Deloitte for $79,010,955.73 plus post-judgment interest of 10 percent per annum and costs.

In its first point, Deloitte argues appellees' cause of action was time barred because the suit was filed outside the two-year statute of limitations for causes of action based on negligence. *See* Tex. Civ. Prac. & Rem. Code Ann. § 16.003 (Vernon 1986). On April 10, 1990, the IRS issued FPAA notices of deficiency to each of the three joint ventures in which Granada 4 had invested. On May 7, 1990, the IRS mailed the notices to GMC, which was serving as the general partner and the "Tax Matters Partner" for the Granada 4 limited partnership. GMC received the FPAAs on May 12, 1990, and notified the limited partners on May 30, 1990 of the FPAAs and of a petition which had been filed in Tax Court challenging the IRS adjustments. On November 15, 1991, GMC entered into settlements with the IRS resulting in disallowances of $79 million worth of Granada 4 tax deductions. Assessments were subsequently sent to each of the

limited partners for their 1986 tax liability and interest. As we have noted, this suit was filed on May 26, 1992.

Deloitte argues the statute of limitations began running on May 7, 1990, when the IRS mailed the FPAAs to Granada. Alternatively, Deloitte argues the statute of limitations began running on May 12, 1990, when GMC received the FPAAs. Of course, if we were to adopt either argument, the suit, having been filed on May 26, 1992, would be time barred.

The purpose of statutes of limitation is to bar the adjudication of suits filed at a time far removed from the injury causing event. This is to prevent the consideration of stale claims and other inefficiencies and imprecision associated with delayed litigation. The statute of limitations begins to run when a cause of action accrues. In *Atkins v. Crosland,* 417 S.W.2d 150, 153 (Tex. 1967), the Supreme Court of Texas stated the general rule[4] that:

> [A] cause of action sounding in tort accrues, in the absence of a statute to the contrary or fraudulent concealment, when the tort is committed. This rule obtains notwithstanding the fact that the damages, or their extent, are not ascertainable until a later date . . . *A legal injury must be sustained, of course, before a cause of action arises.*

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[4] We disagree with the statement in *Sutton v. Mankoff,* 915 S.W.2d 152, 157 (Tex.App. – Fort Worth 1996, writ denied), that *Atkins* stated an exception to the general rule for determining the accrual of a cause of action. As we discuss more fully in our opinion, actual damages are an element of a negligence cause of action without which no tort has been committed. *Sutton* failed to recognize this.

Atkins, 417 S.W.2d at 153 (citations omitted) (emphasis added). A legal injury in tort occurs when the tort is committed and damage suffered. *Black v. Wills*, 758 S.W.2d 809, 816 (Tex.App. – Dallas 1988, no writ). A cause of action only accrues when each element of the tort is satisfied.

Atkins illustrates this rule. In *Atkins*, the IRS commissioner assessed a tax deficiency against the plaintiff after the defendant, an accountant employed by the plaintiff, changed the method by which the plaintiff's income taxes were calculated without first informing the commissioner. The plaintiff subsequently brought a negligence claim against the defendant and sought damages for the amount of the adjustment assessed by the commissioner. The defendant affirmatively pled the statute of limitations with the claim it barred the plaintiff's cause of action. Our supreme court reiterated the following test concerning the triggering of the statute of limitations for a cause of action in tort:

> The test to determine when the statute of limitations begins to run against an action sounding in tort is whether the act causing the damage does or does not of itself constitute a legal injury, that is, an injury giving rise to a cause of action because it is an invasion of some right of plaintiff. If the act is of itself not unlawful in this sense, and plaintiff sues to recover damages subsequently accruing from, and consequent on, the act, the cause of action accrues, and the statute begins to run, when, and only when, the damages are sustained; and this is true although at the time the act is done it is apparent that injury will inevitably result.

> If, however, the act of which the injury is the natural sequence of itself a legal injury to plaintiff, a completed wrong, the cause of action accrues and the statute begins to run from the time the act is committed, even where little, if any, actual damage occurs immediately on commission of the tort.

Atkins, 417 S.W.2d at 153 (quoting 54 C.J.S. *Limitations of Actions* § 168). The court held that the alternate method of calculating the plaintiff's income tax was not in itself an unlawful act which caused a legal injury, but it was the assessment of the tax adjustment which actually caused legal injury. Therefore, the court reasoned, the case was not time barred because the statute of limitations did not begin to run until the tax was actually assessed, not at the time of the negligent act. *Id.* at 154.

The elements of a cause of action for negligence are well established. They are: 1) a legal duty owed by one person to another; 2) a breach of that duty; 3) the breach was an actual cause of injury; and 4) actual injury. *Alm v. Aluminum Co. of America*, 717 S.W.2d 588, 595 (Tex. 1986), *cert. denied*, 498 U.S. 847, 111 S.Ct. 135, 112 L.Ed.2d 102 (1990). *See also Greater Houston Transp. Co. v. Phillips*, 801 S.W.2d 523, 525 (Tex. 1990) (restated as three elements). The statute of limitations begins to run at the earliest point that an action can be maintained. Because actual injury is an element of negligence claim, "[a]n action for negligence cannot be maintained unless some damages result therefrom." *Johnson v. Sovereign Camp., W.O.W.*, 125 Tex. 329, 83 S.W.2d 605, 608 (1935), *overruled on other grounds, Doctors Hospital Facilities v. Fifth Court of Appeals*, 750 S.W.2d 177 (Tex. 1988). *Atkins* and *Johnson* show that

Texas follows the general principle that a plaintiff must show actual damages to maintain a negligence action. *See* PROSSER ON TORTS, § 30, at 165 (5th ed. 1984); 22 Am. Jur. 2d *Damages*, §§ 18, 131 (1988); Restatement (Second) of Torts, 906(c) (1965). Until such damages exist, the plaintiff's cause of action has not yet accrued. *Atkins*, 417 S.W.2d at 153; *Phillips v. Giles*, 620 S.W.2d 750, 751 (Tex. Civ. App. – Dallas 1981, no writ)

Examination of relevant provisions of the Internal Revenue Code support the proposition that a taxpayer does not suffer damages on issuance of a notice of deficiency. When the commissioner of the IRS notifies a person of a tax deficiency, the persons of a tax deficiency, the person has 90 days within which to file a petition for review with the Tax Court. The commissioner is restricted from assessing the tax deficiency within 90 days of notifying the taxpayer or prior to a final decision by the tax Court if a petition in that court has been filed. 26 U.S.C. § 6503 (1996). The Tax Court has jurisdiction to "determine the correctness of deficiency assessments made by the Commissioner of Internal Revenue. It is not bound by the assessment, but had power to raise it or lower it, or to hold that there was no deficiency." *Peerless Woolen Mills v. Rose*, 28 F.2d 661, 662 (5th Cir. 1928) (citation omitted). The "[Tax Court] may investigate anew the issues between the government and the taxpayer, and upon the determination of the appeal it may affirm, set aside, or modify the findings and decision of the commissioner." *Blair v. Oesterlean Machine Co.*, 275 U.S. 220, 227, 48 S.Ct. 87, 89, 72 L.Ed. 249, 253 (1927). Under these authorities, after the IRS has given notice of a claimed deficiency, that claim is not final nor can a deficiency be assessed within

90 days of the notification of the claim or if a petition is filed with the Tax Court, until a final determination has been made of the petition. Furthermore, because the Tax Court can hold that there is no deficiency or it can set aside the findings of the IRS, the claimed deficiency might never be assessed. All of these things being true, it is speculative to say that notice of a claimed deficiency by the IRS constitutes a legal injury which would trigger the running of the statute of limitations when it is restricted from having actual legal significance until the time the deficiency can actually be assessed.

Another aspect of the Internal Revenue Code which is worthy of discussion is the provision which tolls the statutory limitations for assessing and collecting deficiencies in relation to the time of the filing of a tax return and for collecting a deficiency in relation to the time of the assessment. The Code requires taxes to be assessed within three years of the initial filing of the tax return. 26 U.S.C. § 6501. The code further requires that a court proceeding or levy to collect taxes pursuant to an assessment be initiated within ten years of the assessment of the tax. 26 U.S.C. § 6502. Section 6503 of the Internal Revenue Code tolls these statutes of limitation for "the period during which the Secretary is prohibited from making the assessment or from collecting by levy or a proceeding in court (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final), and for 60 days thereafter." 26 U.S.C. § 6503. The fact that such tolling provisions are necessary is also an indication that the notice of deficiency is not final or binding upon the taxpayer. That being true, we believe

their existence strengthens the concept that prior to a final assessment, no legal injury is sustained by the taxpayer.

In espousing its position that appellees' cause of action is time barred, Deloitte relies upon *Ponder v. Brice & Mankoff*, 889 S.W.2d 637 (Tex.App. – Houston [14th dist.] 1994, writ denied), and *Hoover v. Gregory*, 835 S.W.2d 668 (Tex.App. – Dallas 1992, writ denied). In *Ponder*, the court interpreted *Atkins* as applying the rule that "a tort cause of action accrues when the tort is committed, notwithstanding the fact that the damages are not ascertainable until a later date." 889 S.W.2d at 641. In *Hoover*, the court interpreted *Atkins* as establishing a general rule that "a taxpayer's cause of action accrues on a fact specific basis when he discovers a risk of harm to his economic interest, whether that be at the time of assessment or otherwise." 835 S.W.2d at 673.

With regard to the time the statute began to run, the *Atkins* court's ruling was clear and definite, *i.e.*;

> The plaintiff argues that the statute (two year statute of limitation) did not begin to run until the tax deficiency was assessed by the Internal Revenue Service, i.e., only at that time was the tort complained of completed. *We agree with this contention.* (Emphasis added).

Atkins, 417 S.W.2d at 152. If the *Ponder* and *Hoover* cases be interpreted as holding anything other than what we believe is the clear mandate of the *Atkins* court, then we respectfully disagree. Cases discussing the elements of a negligence cause of action uniformly refer to damages resulting from the defendant's conduct, not to the *risk* of damages. *See Greater Houston Transp. Co.*, 801 S.W.2d at

525. Where no damages have occurred, regardless of the probability of their occurrence in the future, the cause of action has not yet accrued. *Phillips*, 620 S.W.2d at 751. Under what we believe is the unequivocal holding of *Atkins*, assessment by the IRS is the date on which a cause of action for accounting negligence accrues. 417 S.W.2d at 152.

In the case at bar, GMC initiated a review of the commissioner's deficiency finding by filing a petition with the Tax Court. As a result of the Tax Court proceedings, GMC entered into settlement agreements with the IRS on November 15, 1991, after which the deficiency assessment became final and the $70 million in disallowances became the legal injury of which appellees complain. We therefore hold the statute of limitations began to run sometime after the settlement of November 15, 1991. Thus, the earliest the two-year limitations period could have possibly ended was November 15, 1993. Appellees' suit was filed on May 26, 1992, which was well within the statutory limitation period and was thus timely filed. Deloitte's first point of error is overruled.

In its second point, Deloitte challenges the trial court's award of the interest appellees paid to the IRS as an element of actual damages. Because the measure of actual damages was resolved by the trial court's January 24 partial summary judgment, in addressing this argument, we must apply the standards governing review of summary judgment proceedings. A summary judgment is proper only when the movant establishes there is no genuine issue of material fact and it is entitled to judgment as a matter of law. *Randall's Food Markets, Inc. v. Johnson*, 891 S.W.2d 640, 644 (Tex. 1995); Tex. R. Civ. P.

166a(c). In deciding whether there is a material fact issue precluding summary judgment, evidence favorable to the non-movant will be taken as true and every reasonable inference resolved in its favor. *Nixon v. Mr. Property Management Co.*, 690 S.W.2d 546, 548-49 (Tex. 1985). To obtain summary judgment in its favor, a plaintiff must conclusively prove its entitlement to prevail on each element of its cause of action as a matter of law. *Thompson v. Chrysler First Business Credit Corp.*, 840 S.W.2d 25, 28 (Tex.App. – Dallas 1992, no writ).

In advancing its proposition, Deloitte contends appellees were not entitled to recover the interest charged by the IRS because it merely compensated the IRS for appellees' detention of the amounts due in 1987, but not paid until after the 1991 settlement with the IRS. It additionally reasons that the benefit accruing to appellees by the use of the money during that time exceeded the amount paid in interest, thereby negating any compensable injury to appellees. Thus, it posits, allowing appellees to benefit from the use of the money and also to allow them to recover for the amount of the IRS assessed interest would allow appellees an unjustified windfall.

Appellees' response to these arguments is that the "penalty interest" they were required to pay to the IRS is recoverable as "liquidated damages." Their argument in support of that position appears to be based upon three propositions. 1) the weight of authority holds interest and penalties paid as a result of accountant negligence are recoverable, 2) because the disallowed deductions related to a tax motivated transaction, the IRS assessments for the delayed payments were penalties rather than interest; and 3) public policy requires accountants be liable for

their negligence regardless of the amount of actual damages.

Before addressing the merits of this question, we can simplify somewhat our discussion by observing that appellees' reference to "liquidated damages" is inappropriate in this negligence case. Liquidated damages are an amount for which the parties to a contract agree to be liable upon breach of the contract. *B.F. Soul Real Estate Inv. Trust v. McGovern*, 683 S.W.2d 531, 534 (Tex.App. – El Paso 1984, no writ); BLACK'S LAW DICTIONARY, 391 (6th ed. 1990); 22 Am.Jur.2d *Damages* § 683 (1988); Restatement (Second) of Contracts § 356 (1981), Bryan Garner, A DICTIONARY OF MODERN LEGAL USAGE, 530 (1987). They must represent a reasonable estimate of anticipated damages upon breach when damages are not readily ascertainable. *Austin Hill Country Realty, Inc. v. Palisades Plaza, Inc.*, 948 S.W.2d 293 (Tex. 1997). Thus, without a contract providing for payment of a specific sum on breach of the contract, there can be no liquidated damages.

Although appellees argue the issue presented by this point has been answered by other Texas courts, for reasons we will later discuss, we do not agree. Therefore, resolution of the issue requires us to examine the purpose of actual damages in a negligence action, the nature of the payments sought to be recovered, the reasoning employed by courts of other jurisdictions when addressing these questions, and the public policy considerations involved.

As we have previously noted, the elements of the common law doctrine of negligence are well established. Reiterated, they are: 1) a legal duty owed by one person

to another; 2) a breach of that duty; 3) that the breach was a proximate cause of the injury; and 4) actual injury. *Alm v. Aluminum Co. of America*, 717 S.W.2d at 595. *See also Greater Houston Transp. Co. v. Phillips*, 801 S.W.2d at 525 (restated as three elements). Because damages are an element of the cause of action, the plaintiff must prove actual damages and, unlike torts such as trespass, may not recover nominal damages. *Johnson v. Sovereign Camp, W.O.W.*, 125 Tex. 329, 83 S.W.2d at 608; PROSSER ON TORTS, § 30 at 165 (5th ed. 1984); 22 Am. Jur. 2d *Damages*, §§ 18, 131 (1988); Restatement (Second) of Torts, § 906(c) (1965). *See also Willis v. Maverick*, 723 S.W.2d 259, 263 (Tex.App. – San Antonio 1986) (Cadena, C.J., dissenting), *affirmed*, 760 S.W.2d 642 (Tex. 1988). *But see Missouri K & T Ry. Co. of Texas v. Maxwell*, 104 Tex. 632, 143 S.W. 1147, 1148-49 (1912).

The purpose of actual damages in civil actions is to compensate the injured plaintiff, rather than to punish the defendant. *Cavnar v. Quality Control Parking, Inc.*, 696 S.W.2d 549, 552 (Tex.1985) (citing PROSSER ON TORTS, § 2). Consequently, a prevailing plaintiff is entitled to actual damages that will most nearly put him in the position that he would have been, but for the defendant's negligence. *Nelson v. Krusen*, 678 S.W.2d 918, 924-25 (Tex. 1984); 22 Am. Jur. 2d *Damages* § 131 (1988).

A correlative rule followed by Texas courts requires that when determining actual damages, a court must offset any special benefit derived by the plaintiff resulting from the tortfeasor's conduct. *Nelson*, 678 S.W.2d at 924 (citing Restatement (Second) of Torts, § 920 (1979)); *Terrell v. Garcia*, 496 S.W.2d 124, 127 (Tex.Civ.App. – San Antonio 1973, writ ref'd n.r.e.), *cert. denied*, 415 U.S. 927,

94 S.Ct. 1434, 39 L.Ed.2d 484 (1974). *See also* 22 Am. Jr. 2d *Damages* §§ 550-551 (1988). This rule is commonly referred to as the "benefits rule."

In their suit, appellees sought to recover the amounts paid to the IRS over and above their actual tax liability, *per se*, rather than collateral injuries such as, for example, damage to their reputation because of the assessment of a tax penalty. That being true, whether these amounts were actually interest or penalties does not affect the applicability of these basic principles. Even so, because appellees place significant emphasis on their position that they are seeking to recover *penalties* assessed by the IRS, we will briefly address that issue. There is no dispute that the IRS applied former Section 6621(c) of the Internal Revenue Code (26 U.S.C. 6621(c) (1988))[5] which provided

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[5] *Repealed* by Pub. L. 101-239, Sec. 7721(b), Dec. 19, 1989, 103 Stat. 2399. The text of Section 6621(c) at the time appellees' tax liability arose provided:

(c) **Interest on substantial underpayments attributable to tax motivated transactions.** –

(1) **In general** – In the case of interest payable under section 6601 with respect to any substantial underpayment attributable to tax motivated transactions, the rate of interest established under this section shall be 120 percent of the underpayment rate established under this section.

(2) **Substantial underpayment attributable to tax motivated transactions.** – For purposes of this subsection, the term "substantial underpayment attributable to tax motivated transactions" means any underpayment of taxes imposed by subtitle A for any taxable year which is attributable to 1 or more tax motivated transactions if the amount of the underpayment for such year so attributable exceeds $1,000.

that interest on substantial underpayments attributable to tax motivated transactions shall be 120 percent of the

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(3) **Tax Motivated transactions.** –

(A) **In general.** – For purposes of this subsection, the term "tax motivated transaction" means –

(i) any valuation overstatement (within the meaning of section 6659(c)),

(ii) any loss disallowed by reason of section 465(a) and any credit disallowed under section 46(c)(8),

(iii) any straddle (as defined in section 1092(c) without regard to subsections (d) and (e) of section 1092),

(iv) any use of an accounting method specified in regulations prescribed by the Secretary as a use which may result in a substantial distortion of income for any period, and

(v) any sham or fraudulent transaction.

(B) **Regulatory authority.** – The Secretary may by regulations specify other types of transactions which will be treated as tax motivated for purposes of this subsection and may by regulations provide that specified transactions being treated as tax motivated will no longer be so treated. In prescribing regulations under the preceding sentence, the Secretary shall take into account –

(i) the ratio of tax benefits to cash invested,

(ii) the methods of promoting the use of this type of transaction, and

(iii) other relevant considerations.

(C) **Effective date for regulations.** – Any regulations prescribed under subparagraph (A)(iv) or (B) shall apply only to interest accruing after a date (specified in such regulations) which is after the date on which such regulations are prescribed.

ordinary underpayment rate established by Section 6621(a)(2).

As support for their argument that the assessments were penalties, appellees primarily rely upon an "admission" by Deloitte partner Ben Anderson and use of the phrase "tax motivated transaction penalty" on a form Granada 4 received from the IRS. Whether the amounts assessed under Section 6621(c) were interest or penalties involves the construction of a statute and is a question of law, not a question of fact subject to admission by a party.[6] Similarly, as a question of law, whatever appellation the IRS might attach is not binding upon a court.

As early as 1931, our supreme court observed that federal courts treat interest on late payments of federal taxes as interest rather than penalties. *Jones v. Williams*, 121 Tex. 94, 45 S.W.2d 130, 136 (1931). The court made this observation in the course of explicating its holding that charges for the late payment of state taxes were actually penalties, regardless of the label assigned to them. 45

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(4) **Jurisdiction of Tax Court.** – In the case of any proceeding in the Tax Court for a redetermination of a deficiency, the Tax Court shall also have jurisdiction to determine the proportion (if any) of such deficiency which is a substantial underpayment attributable to tax motivated transactions.

[6] Additionally, at the same hearing in which appellees contend this "admission" was made, Anderson described the tax motivated interest assessed against appellees in the following way: "it's interest is what it is. It's just simply interest . . . "

S.W.2d at 133.[7] Because the taxes in question are federal, federal law defining their character is dispositive.

Our examination of recent federal appellate opinions addressing section 6621(c) reveal an indifference to defining the character of additions to taxes under that statute. Those cases variously use the terms "interest," *Durrett v. C.I.R.*, 71 F.3d 515, 517 (5th Cir. 1996), *Goldman v. C.I.R.*, 39 F.3d 402, 406 (2nd Cir. 1994), *Illes v. C.I.R.*, 982 F.2d 163, 167 (6th Cir. 1992), *Fazzio v. C.I.R.*, 959 F.2d 630, 631 (6th Cir. 1992); "increased interest," *Anderson v. C.I.R.*, 62 F.3d 1266, 1274 (10th Cir.1995), *Friedmon v. C.I.R.*, 53 F.3d 523, 526 (2nd Cir. 1995), *Erhard v. C.I.R.*, 46 F.3d 1470, 1479 (9th Cir. 1995), *cert. denied*, ___ U.S. ___, 116 S.Ct. 336, 133 L.Ed.2d 235 (1995), *Hildebrand v. C.I.R.*, 28 F.3d 1024, 1028 (10th Cir. 1994), *Matter of Fein*, 22 F.3d 631, 632 (5th Cir. 1994), *Wolf v. C.I.R.*, 4 F.3d 709, 715 (9th Cir. 1993), *Pasternak v. C.I.R.*, 990 F.2d 893, 904 (6th Cir. 1993), *Waters v. C.I.R.*, 978 F.2d 1310, 1313 (2nd. Cir. 1992), *Nickeson v. C.I.R.*, 962 F.2d 973, 978 (10th Cir. 1992), "enhanced interest," *Chamberlain v. C.I.R.*, 66 F.3d 729, 732 (5th Cir. 1995); "penalty interest," *Durrett*, 71 F.3d at 517, *Nicholson v. C.I.R.*, 60 F.3d 1020, 1023 (3rd Cir. 1995), *Feldman v. C.I.R.*, 20 F.3d 1128, 1131 (11th Cir. 1994); *Coleman v. C.I.R.*, 16 F.3d 821, 831 (7th Cir. 1994); and "penalty," *Chakales v. C.I.R.*, 79 F.3d 726, 727 (8th Cir. 1996), *cert. denied*, ___ U.S. ___, 117 S.Ct. 85, 136 L.Ed.2d 42 (1996), *Balkissoon v.*

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[7] After the 1991 change to Section 33.01(c) of the Texas Tax Code providing that interest "is to compensate the taxing entity for revenue lost because of the delinquency," *Jones* is no longer an accurate statement of Texas law on this subject. *See also Irving I.S.D. v. Packard Properties*, 970 F.2d 58, 64 (5th Cir. 1992).

C.I.R., 995 F.2d 525, 526 (4th Cir. 1993), *cert. denied*, 510 U.S. 978, 114 S.Ct. 473, 126 L.Ed.2d 424 (1993), *Pasternack*, 990 F.2d at 904.

As significant as the variety of terms used in these opinions is the fact that several of them use different terms within the same opinion and none of them engage in any analysis of why they use one term over another. The only case we have discovered directly addressing the character of additions to tax liability under Section 6621(c) is *In re Hall*, 191 B.R. 814 (Bankr. Alaska 1995). After examining several factors including the fact that Section 6621 was placed in Chapter 67 of the Internal Revenue Code which was titled "interest" rather than being placed in Chapter 68, entitled "assessable penalties," as well as considering the legislative history of the statute, the Alaska bankruptcy court found that interest imposed under Section 6621(c) was not a penalty. The opinion is well reasoned and to the degree it may have an impact upon our disposition of this case, we will adopt and follow that court's reasoning.

Authorities

In support of their argument that Texas courts recognize that IRS assessed penalty interest is recoverable as damages, appellees cite four Texas cases. Those cases are *Bankruptcy Estate of Rochester v. Campbell*, 910 S.W.2d 647 (Tex.App. – Austin 1995, writ granted); *Ponder v. Brice & Mankoff*, 889 S.W.2d at 637; *Hoover v. Gregory*, 835 S.W.2d 668 (Tex.App. – Dallas 1992, writ denied); and *Greenstein v. Burgess Marketing*, 744 S.W.2d 170 (Tex.App. – Waco

1987, writ denied). However, with the exception of *Greenstein,* in each of these cases the dispositive question before the court was whether the suits were barred by limitations. None of the cases discussed the recoverability of interest on back taxes resulting from the defendant's negligence or malpractice. Moreover, each of these cases involved plaintiffs induced into transactions by the defendants' conduct. In *Rochester,* the court observed, without discussion, that the plaintiffs could recover the *additional tax liability* resulting from the transaction negligently structured by the defendant. The accuracy of that statement is largely irrelevant in resolving the question before us. Here, the appellees' claims are not that Deloitte's negligence increased their tax liability but that it prevented them from determining their correct tax liability when it was due, resulting in the subsequent assessment of interest. While *Rochester* applies the rule that a negligent defendant is liable for the injury resulting from its negligence, it offers no insight as to when a defendant may offset against that liability benefits to the plaintiff arising from the tort.

Although *Greenstein* was also an accountant malpractice case, the question of damages was resolved solely by comparing the value of the business as shown by the negligent accountant and its actual value. There was no discussion of IRS-assessed interest or penalties with reference to the question of damages. It likewise offers no assistance in determining if Deloitte is entitled to offset the value of appellees' use of the money between the date it was owed to the IRS and the date it was actually paid.

Because of our failure to uncover any dispositive Texas authority determining this question, bearing in

mind that they are no more than persuasive, we will consider the approaches to this question by courts of other jurisdiction. *Mauzy v. Legislative Redistricting Board,* 471 S.W.2d 570, 571 (Tex. 1971). We also look to those other decisions, not necessarily with the intent merely to follow the majority but, rather, to examine the reasoning supporting their decisions.

Deloitte cites and relies upon the following cases: *DCD Programs, Ltd. v. Leighton,* 90 F.3d 1442 (9th Cir. 1996); *Leenderisen v. Price Waterhouse,* 916 P.2d 449 (Wash.Ct.App. 1996); *Stone v. Kirk,* 8 F.3d 1079, 1093 (6th Cir. 1993), *Gudschinsky v. Hartill,* 815 P.2d 851 (Alaska 1991); *In re Securities Group,* 124 B.R. 875 (Bnkr.M.D.Fla. 1991); *Alpert v. Shea Gould Climenko & Casey,* 559 N.Y.S.2d 312 (1990), *Orsini v. Bratten,* 713 P.2d 791 (Alaska 1986); *Freschi v. Grand Coal Venture,* 767 F.2d 1041 (2nd Cir. 1985), *vacated on other grounds,* 478 U.S. 1015, 106 S.Ct. 3325, 92 L.Ed.2d 731 (1986).

The leading case in this group is the *Freschi* case. That case, along with *DCD Programs, Stone,* and *In re Securities Group* primarily involved claims of securities fraud rather than negligence. In each of those cases, the court held that interest on back taxes was not recoverable as damages. These holdings were based on the concept that damages must be limited to actual loss, *see e.g.,* 767 F.2d at 1051; 124 B.R. at 903, and that to permit the plaintiffs to have use of the money owed to the government and also recover interest from the defendants would grant them a windfall. 90 F.3d at 1451 and 767 F.2d at 1051. For example, in explicating that reasoning, *Stone* said:

> Neither are the Stones entitled to recover the interest they had to pay on their back taxes, at least insofar as the IRS charged a market rate of interest. The Stones had the use of the tax money, of course, until the money was belatedly turned over to the IRS.

Stone, 8 F.3d at 1093. In *Alpert*, a New York appellate court also followed the holding in *Freschi* and the other cases of like ilk and disallowed recovery of interest paid on back taxes. 559 N.Y.S.2d at 315. The *Alpert* court also noted the potential windfall for the plaintiffs if they were allowed to have use of the money and recover interest from the defendants. *Id.*

It is worthy of note that in these cases the courts implicitly assumed, without discussion, that the plaintiffs were able to earn interest on the funds owed to the government. That inference was expressed more directly in *Orsini*. In holding that the plaintiff, Bratten, could not recover the interest paid to the IRS, the Alaska Supreme Court wrote: "The Brattens had the use of these monies and, *presumably*, were able to earn interest while they held it. Therefore, paying the interest penalties effectively cost the Brattens nothing." 713 P.2d at 794 (emphasis added). Five years later, the same court held the executor of an estate was not liable to the estate for interest which resulted because of her failure to timely file the estate's tax returns. In that case, there was evidence that the estate was generating interest on the funds improperly withheld. *Gudschinsky*, 815 P.2d at 856.

In *Leendertsen v. Price Waterhouse*, the plaintiffs brought suit against Price Waterhouse for negligence in the preparation of their tax returns. The trial court had

allowed the plaintiffs to recover interest they had paid the IRS. On appeal, Price Waterhouse argued that the trial court erred in allowing a recovery for that interest because "as a matter of law such interest is not damages but rather reflects the value of the use of the money that should have been paid as taxes." In opposing that argument, the Leendertsens responded that "the collateral source rule provides that any income resulting from the use of the money was irrelevant," such interest could not be considered as the value of the use of the money, and they were entitled to receive the amount of the interest as an element of their damage. *Leendertsen*, 916 P.2d at 451. The Washington court examined each of the above cases holding that interest paid the IRS was not recoverable and concluded those decisions were correctly decided. In doing so, it quoted excerpts form *Freschi* and *Orsini* to the effect that to allow the recovery of interest as an element of damage would be to allow the plaintiffs a windfall because such plaintiffs had the use of the money during the period of the underpayments. It concluded the collateral source rule was not applicable because that rule only prevented consideration of money received from an independent source which would not include the use of the money because of underpayment of the taxes in question. Thus, it concluded, "[W]e follow the majority of jurisdictions holding that interest paid to the IRS is not recoverable." *Id.* Unlike the cases which it followed, *Leendertsen* went so far as to preclude the plaintiffs from rebutting the presumption that the use of the underpayment money was sufficient to offset the IRS interest on the assessment. 916 P.2d at 452.

Appellees have cited numerous cases from other jurisdictions in support of their proposition that interest paid on the back taxes is recoverable. However, as with appellees' Texas authorities, many of these cases discuss, and were decided on, issues other than damages. Consequently, the do not help in resolving Deloitte's second point.[8] *See Mauzy*, 471 S.W.2d at 573. Also, under Rule 90 of the Rules of Appellate Procedure, we are not permitted to consider the unpublished cases cited by either party. *Dickey v. Dickey*, 908 S.W.2d 311, 313 (Tex.App. – San Antonio 1995, no writ); *Carlisle v. Philip Morris, Inc.*, 805 S.W.2d 498, 501 (Tex.App. – Austin 1991, writ denied).

Two of appellees' cases, *In re Estate of Snover*, 546 N.W.2d 341 (Neb. App. 1996) and *Estate of Ridl v. Ridl*, 455 N.W.2d 188 (N.D. 1990), involved suits against executors for breach of fiduciary duty. *Snover* did involve an award of interest assessed by the IRS against the executor of an estate. 546 N.W.2d at 345-46. However, the propriety of that award was not questioned before the appellate court. *Ridl* was an action for reimbursement of excessive fees, overdraft charges, lost interest, and penalties and interest

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[8] The following cases cited by appellees address the question of limitations in similar suits: *Eliot v. Parsons*, 918 P.2d 592 (Idaho 1996); *LaMure v. Peters*, 924 P.2d 1379 (N.M.Ct.App. 1996), *Mud Trans., Inc. v. Foster Dickenson*, 856 P.2d 282, 284 (Okla. 1993); *International Engine Parts, Inc. v. Fedderson & Co.*, 888 P.2d 1279 (Cal. 1995), *Boone v. C. Arthur Weaver Company, Inc.*, 365 S.E.2d 764 (Va. 1988); *Streib v. Viegal*, 706 P.2 63 (Idaho 1985); *Leonhart v. Atkinson*, 289 A.2d 1 (Md. 1972); *Moonie v. Lynch*, 64 Cal. Rptr. 55 (Cal.Ct.App. 1967). Other cases cited by appellees address other issues not relevant here. *See Estate of Logan v. Northwestern National Casualty Co.*, 424 N.W.2d 179 (Wis. 1988) (Coverage of attorney malpractice policy).

for improperly filed tax returns in which the court held the executor of an estate was liable to the estate for a breach of fiduciary duty. 455 N.W.2d at 193. However, the underlying facts are not detailed in the opinion, making it of limited value here.

The remaining cases cited by appellees involve, *inter alia*, malpractice claims against attorneys or accountants. *Adel v. Parkhurst*, 681 P.2d 886 (Wyo. 1984), involved a negligence claim against an accountant for failing to complete the plaintiffs' tax returns before they were due. Although the court permitted the recovery of "interest and penalties" charged by the IRS as a result of the delay, the issues raised in the appeal were the propriety of punitive damages and the defendant's right to vacate the default judgment against him. There was no challenge to the composition of the actual damages awarded.

In *Jerry Clark Equipment, Inc. v. Hibbits*, 612 N.E.2d 858 (Ill. App. Ct. 1993), the trial court awarded the plaintiff $18,324.82 for accountant malpractice, which included $8,033.60 for penalties and interest. *Id.* at 934. The defendant did not challenge the specific elements of the damages award but rather challenged the award generally. The appellate court held the defendant's failure to cite supporting authority waived the argument. *Id.* at 938. It also observed the damages were "based entirely upon matters of record and was for damages actually sustained by plaintiff as a result of defendant's negligence. . . . " *Id.* There was no discussion of the plaintiff's use of the money before it was paid to the government.

Dail v. Adamson, 570 N.E.2d 1167 (Ill. App. Ct. 1991) another Illinois case, arose from a suit against an accountant for malpractice and breach of contract. In that case, the plaintiff sought recovery of the interest and penalties assessed by the State of Illinois for taxes not paid because of the defendant's negligence. the trial court allowed recovery of the penalties but denied recovery of interest because the plaintiff had use of the money before it was paid to the state. The trial court also "felt that it would be speculative to attempt to ascertain the value of the money to the plaintiff and offset it against the interest charged by the [state]." *Id.* at 1168.

The appellate court held that the interest on the back taxes was recoverable and, in reaching that conclusion, relied upon and quoted from *Thomas v. Cleary*, 768 P.2d 1090 (Alaska 1989), as follows:

> In a case addressing the issue of a tax preparer's liability, the Supreme Court of Alaska stated: "the appropriate measure of damages is the difference between what the (taxpayers) would have owed in any event if the tax returns were properly prepared, and what they owe now because of their accountants' negligence, plus incidental damages" *Thomas v. Cleary* (Alaska 1989), 768 P. 2d 1090, 1091-92 (footnote 5).

However, examination of the case reveals that the Alaska court actually disposed of the case by holding that the plaintiff's cause of action had not yet accrued. The quoted footnote actually began with the words "we hold that if the malpractice action ripens, the appropriate measure of damages is. . . . " We do not agree with appellees' characterization that *Dail* "expressly considered and

rejected the very argument [appellant] now asserts." Because the case was decided on other grounds, the appellate court did not actually review the trial court's denial of recovery for interest or its reasons for that denial. Additionally, because of the Alaska Supreme Court's prior ruling to the contrary in the *Orsini* case and its subsequent ruling, also to the contrary, in the *Gudschinsky* case, we can give little weight to the *Dail* holding. *See Orsini v. Britten*, 713 P.2d at 794, and *Gudschinsky v. Hartill*, 815 P.2d at 856.

In *Harrell v. Crystal*, 611 N.E.2d 908 (Ohio Ct. App. 1992), a client had sued his attorney for, *inter alia*, professional negligence arising from the attorney's advice that the client invest in a tax shelter subsequently disallowed. The trial court calculated the client's actual damages by deducting the amount of taxes the plaintiffs would have owed had they not invested in the tax shelter from the IRS assessment, which included interest. The appellate court held that the plaintiffs could recover the interest assessed by the IRS as "a pecuniary loss which is a direct consequence of appellant's negligence." *Id.* at 913. The court did not address the question of the plaintiffs' use of the money.

Wynn v. Estate of Holmes, 815 P.2d 1231 (Okla. Ct. App. 1991), is factually very similar to the case before us in that the plaintiffs sought recovery of the interest assessed by the IRS for late payment of income taxes due to their accountant's negligence. The trial court had overruled the defense of limitations and permitted recovery of interest paid to the IRS without any offset for the plaintiff's use of the money. In affirming the trial court's judgment, the court of appeals specifically held that

"benefits rule" was not applicable and the collateral source rule precluded the plaintiffs' damages from being reduced by any payments they had received from another source. *Id.* at 1235. In doing so, the court observed the evidence showed the taxes that were not paid when due were not invested and the plaintiffs were required to obtain a loan with which to pay the IRS assessment.

The cases cited by both Deloitte and appellees support the general principle of negligence damages that a defendant is responsible for all the injury flowing from its tortious conduct. It is not necessary to extensively discuss the applicability of that basic principle. Each of the cases cited by Deliotte also address the reasoning behind the "benefits rule"[9] as stated in Section 920 of the Restatement (Second) of Torts, and followed in this state. *See, e.g., Nelson v. Krusen*, 678 S.W.2d at 924. Each of those cases indulged in the presumption that the plaintiff was able to earn sufficient interest on the funds withheld to entirely offset the amount of interest charged by the IRS. As we have noted, only *Leendertsen*, precluded the plaintiff from rebutting that presumption.

Of the cases upon which appellees rely, only the *Wynn* case addressed the benefits rule. We are unwilling to interpret the failure of the other cases to discuss the benefits rule as a persuasive argument that the rule is not applicable to this case. *See Mauzy*, 471 S.W.2d at 573. In the *Wynn* case, the court held the benefits rule was not applicable because the case relied upon by the defendant

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[9] In awarding damages, the court must offset any special benefits to the plaintiff resulting from the defendant's negligence.

in invoking the benefits rule was a wrongful life case, factually distinguishable from the case before it. Parenthetically, some cases which have applied the benefits rule in Texas have also involved attempts to assert claims of wrongful life. *See Nelson*, 678 S.W.2d at 924 (holding there is no such cause of action in Texas). We also not that in *Nelson*, the court specifically cited the Restatement Section 920 as stating a general rule of tort damages. *Id.* at 924.

In *Wynn*, the court also held the collateral source rule would apply and would preclude any reduction of damages fro the plaintiff's use of the money. 815 P.2d at 1235. We initially note the evidence in that case indicated that the plaintiffs there did not invest the funds withheld from the government, and therefore derived no benefit from them, probably renders this holding dicta. Additionally, appellees here have not attempted to invoke the collateral source rule in support of their position. However, in the interest of a full discussion of matters bearing upon our decision, we will address that doctrine.

As we have noted above, in the *Leendertsen* case, the Washington court expressly rejected the applicability of the collateral source rule when determining whether to apply the benefits rule in a case of a nature like unto this one. The court held the rule was not applicable because the benefits the defendant sought to offset against the plaintiff's damages were not paid as compensation for their injuries. *Id.*

The collateral source rule is stated in Section 920A(2) of the Restatement (Second) as:

> (2) Payments made to or benefits conferred on the injured party from other sources are not credited against the tortfeasor's liability, although they cover all or a part of the harm for which the tortfeasor is liable.

Comment b to the section discusses the applicability of that section in terms of insurance maintained by the plaintiff, gifts and benefits established by law. *Id.*

In general terms, the collateral source rule provides that a tortfeasor's liability cannot be offset by an independent source compensating the plaintiff for the same injury. *See Leendertsen*, 916 P.2d at 451. Texas courts have adhered to this formulation of the rule. For example, in *Brown v. American Transfer and Storage Co.*, 601 S.W.2d 931, 934 (Tex. 1980), *cert. denied*, 449 U.S. 1015, 101 S.Ct 575, 66 L.Ed. 2d 474 (1980) (citing *Texas & Pacific Ry Co. v. Levi & Bro*, 59 Tex 674 (1993)), in applying the collateral source rule, out supreme court held that a wrongdoer should not have the benefit of insurance independently procured by the injured party and to which the wrongdoer was not privy. Other Texas courts have held the rule is applicable to gifts, *Lee-Wright, Inc. v. Hall*, 840 S.W.2d 572, 582 (Tex.App. – Houston [1st Dist.] 1992, no writ), and free public services, *Hall v. Birchfield*, 718 S.W.2d 313, 338 (Tex.App. – Texarkana 1986), *rev'd on other grounds*, 747 S.W.2d 361 (Tex 1987). Because the interest in question directly arises from the tax underpayment, not from an independent and other source, the collateral source rule is not applicable here.

Thus far, we have determined that the general rule of damages in negligence actions allowing the recovery for

any harm proximately caused by the defendant's negligence is applicable here. Additionally, we find nothing to preclude application in this case of the benefits rule which we have discussed above. Having decided that the benefits rule would be applicable, it next becomes necessary for us to determine who would bear the burden of proof on the question of whether the plaintiffs benefited from the use of money owed to the government and if so, how much.

It is well established that "[w]here facts lie peculiarly within the knowledge of a party and cannot in the nature of the case be known to his adversary, the party having the knowledge has the burden of proving such facts." *Eaton v. Husted*, 141 Tex. 349, 358, 172 S.W.2d 493, 498 (1943); *Matter of Marriage of DeVine*, 869 S.W.2d 415, 424 (Tex.App. – Amarillo 1993, writ denied.) In this case, the benefit, if any, which the plaintiffs derived from the use of the money, and if so, how much, is a matter peculiarly within their knowledge.

When a defendant has raised the benefits rule, the trial court must begin with the presumption that the plaintiffs derived sufficient return from the use of the amounts withheld to offset the interest charged by the IRS. *See, e.g., Orsini*, 713 P.2d at 794. However, as noted in cases such as *Stone*, this presumption should only apply "at least insofar as the I.R.S. charged a market rate of interest." 8 F.3d at 1093. Contrary to Deloitte's contention, the "market rate of interest" must be the rate at which the plaintiffs could earn interest on the funds withheld, not the rate at which they could borrow an equivalent

amount.[10] To hold otherwise would not put the plaintiffs in the position they would have been in, absent Deloitte's alleged negligence, even if they had invested the funds. In determining the market rate of interest, the trial court should begin with the presumption the ordinary underpayment rate set by Section 6621(a) of the Tax Code is the market rate.

Beginning with the presumption that the plaintiffs were able to earn sufficient interest to offset ordinary IRS underpayment interest rate, the plaintiffs are free to offer evidence that they derived no benefit, or that any benefit derived was insufficient to offset a portion of the interest for which they were liable. Conversely, Deloitte may offer evidence showing the plaintiffs, individually or by subclass, were able to earn enough to offset the entire tax motivated rate of interest.

In arriving at our decision, we have considered the public policy arguments advanced by both sides. Deloitte argues it would be unjust for appellees to have use of money to which the government was entitled and also recover from it the interest paid to reimburse the government for its loss of use of that money. Appellees argue that a holding that Deloitte is not liable for the interest assessed by the IRS would insulate Deloitte, and all accountants, from liability for their negligence.[11]

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[10] Evidence on how this rate might be calculated was actually introduced by Deloitte in a bill of exceptions in the trial court.

[11] This is the reasoning apparently followed by the trial court.

In considering these competing viewpoints, we have borne in mind that the purpose of compensatory damages is to compensate for actual loss, not to deter or punish. Thus, we must reject appellees' argument that liability for interest paid the IRS is justified as a deterrent or punishment. On the other hand, there is evidence that some of the plaintiff class were unable to pay the IRS assessed interest and were required to obtain loans to satisfy the assessment. The blanket rule advanced by Deliotte would be unjust in such instances. We believe the approach we have taken adequately addressees the public policy arguments advanced by both sides.

We must next determine whether Deloitte had, in fact, raised the issue of offset under the benefits rule. Our examination of the record satisfies us that the issue had been raised. At an October 23, 1993 hearing, the trial court considered a motion in limine filed by appellees which, *inter alia*, required Deloitte to seek a ruling before presenting evidence of any benefit derived by the class members from their use of the money. At the time, Deloitte unequivocally expressed its intent to introduce such evidence. Just before trial, Deloitte expressed its desire and was informed by the trial court that "we're going to cross that bridge when we get to it, which is not this trial." During a bill of exceptions made on October 29, 1993, the trial court told Deloitte that in reference to the jury's determination of exemplary damages, it could argue to the jury that the class members had the use of the money and derived a benefit from that use for the purpose of showing that actual damages were lower than those claimed by appellees. The benefit claim was also

urged in Deloitte's October 21, 1994 response to appellees' motion for partial summary judgment.

It is also worthy of note that until the partial summary judgment, the trial court declined to rule on the issue of what portion, if any, of the interest paid by the class members was recoverable as damages, leaving the issue of offset subject to argument and proof by the parties. The issue was raised several times during the October 22, 1993 pretrial hearing and, at a post-trial hearing held December 20, 1993, the trial court expressly stated it was reserving a decision on what portion of the interest was recoverable. The issue was also raised in Deloitte's January 14, 1994 summary judgment motion. Additionally, at the October 23, 1994 hearing on appellees' motion for summary judgment, the court entertained additional argument on the question.

We also disagree with appellees' contention that Deloitte "agreed that determination of actual damages did not present any issue of fact."[12] Our review of the pertinent portions of the record shows that although Deloitte conceded there was no fact question as to the amount of interest paid by the individual class members, it did not concede that amount was recoverable as actual damages. Indeed, the trial court's statements, both before and after trial, that it was reserving decision on what portion of the interest might be recoverable, was wholly inconsistent with the existence of an agreement on that issue.

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[12] Motion for partial summary judgment at 1.

For all of the above reasons, the trial court erred in rendering judgment awarding all of the interest paid by the members of the class as damages. We must, and do, sustain Deloitte's second point.

We do note that in its partial summary judgment, the trial court separately stated the amount of interest attributable to the ordinary interest rate charged by the IRS and the additional amount attributable to the tax motivated interest rate in the hope that if an appellate court found a portion of the interest unrecoverable, it could render judgment for the remainder without the necessity of a remand. Unfortunately, our disposition of Deloitte's second point does not permit us to take advantage of the trial court's foresight. Initially, because Deloitte contests its liability, we may not remand for the determination of damages alone. Tex. R. App. P. 81(b)(1). Additionally, the parties must be given the opportunity to present evidence rebutting the presumptions described above If they choose to do so. Finally, appellees' motion for summary judgment does not show which members of the plaintiff class had underpaid their 1986 taxes by less that $1,000, the minimum underpayment necessary for application of tax motivated interest.[13] Indeed, even if the parties did not seek to rebut the presumptions adopted above, simply reducing the interest rate and the tax motivated rate would require that we presume the interest assessed against all the claimants was at the tax motivated rate. A random sampling of the claims submitted by the class

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[13] This court cannot search the 110,000 pages of the exhibits in an attempt to locate this information.

members shows that such a presumption would be incorrect.

We are mindful of the potentially significant logistical difficulty of collecting and presenting the relevant facts from each of the members of the plaintiff class who choose to rebut the presumptions we have described. However, this difficulty cannot alter the fact that the parties are entitled to a lawful resolution of their dispute. On remand, the trial court may, for example, permit the issue of liability to be maintained as a class while reserving the question of actual damages for disposition individually or by subclass. Tex. R. Civ. P. 32(d); *Franklin v. Donoho*, 744 S.W.2d 308, 312-13 (Tex.App. – Austin 1989, no writ) (affirming certification of class where damages for up to 18,000 class members would require individual determination); *Horton v. Goose Creek Indep. Sch. Dist*, 690 F.2d 470 (5th Cir. 1982), *cert. denied*, 463 U.S. 1207, 103 S.Ct. 3536, 77 L.Ed.2d 1387 (1983).

Our disposition of Deloitte's second point requires us to reverse the judgment and remand this cause to the trial court. Our remand obviates the necessity for discussion of Deloitte's remaining points as they concern matters which may or may not arise upon retrial.

John T. Boyd
Chief Justice

Publish.

APPENDIX 2

NO. 07-96-0324-CV

IN THE COURT OF APPEALS

FOR THE SEVENTH DISTRICT OF TEXAS

AT AMARILLO

PANEL D

APRIL 14, 1998

DELOITTE & TOUCHE, APPELLANTS

V.

HARVILL E. WELLER, JR. AND
FREDERICK B. WOOKEY, JR., APPELLEES

FROM THE 234TH DISTRICT COURT OF
HARRIS COUNTY;

NO. 92-023452; HONORABLE
SCOTT A. BRISTER, JUDGE

Before BOYD, C.J., and QUINN and REAVIS, JJ.

ON MOTIONS FOR REHEARING

In response to the motions for rehearing filed by both parties to this appeal, we withdraw our opinion of September 16, 1997, and substitute the following opinion in its place.

This appeal arises from a class action brought by limited partner investors in Granada 4, a Texas limited partnership formed to engage in agriculture and food production. Harvill E. Weller, Jr. and Frederick B.

Wookey, Jr. are the representative members of the appellee class. The suit was brought against appellant Deloitte & Touche (Deloitte) for alleged negligence in preparing the partnership's tax return. In 15 points, Deloitte contends the trial court erred in rendering judgment against it for interest paid on back taxes to the Internal Revenue Service and for exemplary damages. For reasons we later express, we must reverse the judgment of the trial court and render judgment that appellees take nothing.

A proper consideration of Deloitte's challenges requires us to recount the factual and procedural history of this dispute. In 1986, the Granada 4 limited partnership consisted of 10,358 limited partners and one general partner, Granada Management Corporation (GMC). Granada 4 was designed and operated as a registered tax shelter for the limited partners. The partnership obtained tax benefits deferring and converting ordinary income into capital gains by investing in joint ventures involving agriculture. Several of these joint ventures were with other limited partnerships formed by GMC.

One of the joint ventures in which Granada 4 invested in 1986 involved the purchase of 800,000 cattle to graze on land leased by the partnership. The objective was to permit the partnership, and consequently the partners, to take a deduction for the cost of keeping the cattle at pasture. This deduction is referred to as the pasturage deduction. At the end of 1986, GMC hired Deloitte to prepare and sign the partnership's 1986 tax return. That return included a 95 million dollar pasturage deduction.

It was signed by Deloitte partner Ben Anderson.[1] Based on information provided to them in K-1 forms sent out by GMC, the limited partners took deductions on their individual returns in proportion to their investment in the partnership.

The Internal Revenue Service (IRS) subsequently audited the 1986 returns of Granada 4 and the joint ventures in which it had invested. As a result of the audits, the IRS disallowed numerous deductions taken by these entities. The disallowed deduction that is the primary focus of this litigation is the pasturage deduction. The IRS determined that there was no, or at least inadequate, evidence showing that the joint ventures owned cattle at pasture in 1986. On April 10, 1990, the IRS sent notices of deficiency, each entitled Final Partnership Administrative Adjustment (FPAA) to three of the joint ventures. A corresponding notice was sent to Granada 4 the following month. GMC informed the limited partners of the FPAA and GMC's challenge thereto on May 30, 1990.

On November 15, 1991, GMC entered into three settlement agreement with the IRS, one for each of the joint ventures whose deductions were disallowed. The disallowed deductions totaled 79 million dollars. The pasturage deductions accounted for only a portion of this amount but, appellees contend, the partnership's position was so weak on that issue that it was forced into a

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[1] Anderson also signed the returns of the joint ventures in which Granada 4 invested.

settlement. Because the settlements avoided the imposition of substantial penalties by the IRS, there is no dispute whether the settlements were appropriate.

The IRS assessed back taxes and interest against the limited partners. Appellees Harvell E. Weller, Jr. and Frederick B. Wookey, Jr., acting as representative members of a class consisting of all the limited partners in the Granada 4 limited partnership, filed suit against Deloitte on May 26, 1992. In the suit, appellees claimed Deloitte was negligent and grossly negligent in the preparation of the partnership's 1986 tax return by failing to investigate the basis for the deductions asserted by the partnership. They further alleged that Deloitte knew there were no records supporting the pasturage deduction before it signed the 1986 tax return and that it attempted to conceal this fact by generating false documentary evidence showing that the partnership had cattle at pasture when in fact it did not. In the suit, appellees sought actual damages of over 34 million dollars, exemplary damages and pre- and post-judgment interest.

Because the trial court believed that determining the amount of actual damages would not present a fact question, the parties went to trial on the issues of liability and exemplary damages beginning October 26, 1993. On November 1, 1993, the jury returned a verdict finding Deloitte and the "Granada Entities"[2] negligent, that their

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[2] These were defined to include GMC, Granada Cattle Services, Inc., Granada Corporation, Inc., the Granada 4 partnership, and their agents, employees, officers, and directors.

negligence proximately caused "the occurrence in question," and assigning 60 percent responsibility to Deloitte and 40 percent to the Granada entities. The jury also found Deloitte's negligence to be gross negligence and found $77,685,000 in exemplary damages. The question of actual damages was resolved pursuant to a claims procedure advocated by appellees. Under the plan, appellees would bear the expense of notifying the class members, collect documentation of the amount of interest assessed by the IRS, total the results and present this information to the court. The trial court suggested that the question of actual damages be resolved by "something that looks like a summary judgment proceeding" so that an appellate court would know how to analyze it.

On September 26, 1994, appellees filed their motion for summary judgment on the issue of actual damages. On December 13, 1994, the trial court sent a letter to the parties setting out its intended disposition of the remaining issues. On January 27, 1995, the trial court granted appellees' motion for partial summary judgment on actual damages and also rendered a final judgment in the suit. That judgment awarded appellees $79,010,955.73 plus post-judgment interest of 10 percent per annum and costs.

In its first point, Deloitte argues appellees' cause of action was time barred because the suit was filed outside the two-year statute of limitations for causes of action based on negligence. *See* Tex. Civ. Prac. & Rem. Code Ann. § 16.003 (Vernon 1986 & Supp. 1998). On April 10, 1990, the IRS issued FPAA notices of deficiency to each of the three joint ventures in which Granada 4 had invested. On May 7, 1990, the IRS mailed the notices to GMC,

which was serving as the general partner and the "Tax Matters Partner" for the Granada 4 limited partnership. GMC received the FPAAs on May 12, 1990, and notified the limited partners on May 30, 1990 of the FPAAs and of a petition which had been filed in tax Court challenging the IRS adjustments. On November 15, 1991, GMC entered into settlements with the IRS resulting in disallowances of $79 million worth of Granada 4 tax deductions. Assessments were subsequently sent to each of the limited partners for their 1986 tax liability and interest. As we have noted, this suit was filed on May 26, 1992.

Deloitte argues the statute of limitations began running on May 7, 1990, when the IRS mailed the FPAAs to Granada. Alternatively, Deloitte argues the statute of limitations began running on May 12, 1990, when GMC received the FPAAs. Of course, if we were to adopt either argument, the suit, having been filed on May 26, 1992, would be time barred.

The purpose of statutes of limitation is to bar the adjudication of suits filed at a time far removed from the injury causing event. This is to prevent the consideration of stale claims and other inefficiencies and imprecision associated with delayed litigation. The statute of limitations begins to run when a cause of action accrues. Tex. Civ. Prac. & Rem. Code Ann. § 16.003(a) (Vernon Supp. 1998). In *Atkins v. Crosland*, 417 S.W.2d 150, 153 (Tex. 1967), the Supreme Court of Texas stated the general rule that:

> [A] cause of action sounding in tort accrues, in the absence of a statute to the contrary or fraudulent concealment, when the tort is committed. This rule obtains notwithstanding the fact that

> the damages, or their extent, are not ascertainable until a later date. . . . *A legal injury must be sustained, of course, before a cause of action arises.*

Atkins, 417 S.W.2d at 153 (citations omitted) (emphasis added). It has long been the rule that a legal injury in tort occurs when the tort is committed and damage suffered. *Black v. Wills*, 758 S.W.2d 809, 816 (Tex.App. – Dallas 1988, no writ). It has also been the rule that a cause of action only accrues when facts come into existence supporting each element of the tort. *Murray v. San Jacinto Agency, Inc.*, 800 S.W.2d 826, 828 (Tex. 1990); *Stroud v. VBFSB Holding Corp.*, 917 S.W.2d 75, 80 (Tex.App. – San Antonio 1996, writ denied).

A claim for professional malpractice is based in negligence. *See e.g., Cosgrove v. Grimes*, 774 S.W.2d 662, 664 (Tex. 1989). The elements of a cause of action for negligence are well established. They are: 1) a legal duty owed by one person to another; 2) a breach of that duty; 3) the breach was an actual cause of injury; and 4) actual injury. *Alm v. Aluminum Co. of America*, 717 S.W.2d 588, 595 (Tex. 1986), *cert. denied*, 498 U.S. 847, 111 S.Ct. 135, 112 L.Ed.2d 102 (1990). *See also Greater Houston Transp. Co. v. Phillips*, 801 S.W.2d 523, 525 (Tex. 1990) (restated as three elements). Because actual injury is an elements of a negligence claim, "[a]n action for negligence cannot be maintained unless some damages result therefrom." *Johnson v. Sovereign Camp., W.O.W.*, 125 Tex. 329, 83 S.W.2d 605, 608 (1935), *overruled on other grounds, Doctors Hospital Facilities v. Fifth Court of Appeals*, 750 S.W.2d 177 (Tex. 1988). *Atkins* and *Johnson* show that Texas has followed the general principle that a plaintiff must show actual damage to maintain a negligence action. *See* PROSSER ON

TORTS, § 30, at 165 (5th ed. 1984); 22 Am. Jr. 2d *Damages*, §§ 18, 131 (1988); Restatement (Second) of Torts, 906(c) (1965). Until such damages exist, the plaintiff's cause of action has not yet accrued. *Atkins*, 417 S.W.2d at 153; *Phillips v. Giles*, 620 S.W.2d 750, 751 (Tex.Civ.App. – Dallas 1981, no writ).

Atkins illustrated these rules. In *Atkins*, the IRS commissioner assessed a tax deficiency against the plaintiff after the defendant, an accountant employed by the plaintiff, changed the method by which the plaintiff's income taxes were calculated without first informing the commissioner. The plaintiff subsequently brought a negligence claim against the defendant and sought damages for the amount of the adjustment assessed by the commissioner. The defendant affirmatively pled the statute of limitations with the claim it barred the plaintiff's cause of action. Our supreme court reiterated the following test concerning the triggering of the statute of limitations for a cause of action in tort:

> The test to determine when the statute of limitations begins to run against an action sounding in tort is whether the act causing the damage does or does not of itself constitute a legal injury, that is, an injury giving rise to a cause of action because it is an invasion of some right of plaintiff. If the act is of itself not unlawful in this sense, and plaintiff sues to recover damages subsequently accruing from, and consequent on, the act, the cause of action accrues, and the statute begins to run, when, and only when, the damages are sustained; and this is true although at the time the act is done it is apparent that injury will inevitably result.

> If, however, the act of which the injury is the natural sequence is of itself a legal injury to plaintiff, a completed wrong, the cause of action accrues and the statute begins to run from the time the act is committed, even where little, if any, actual damage occurs immediately on commission of the tort.

Atkins, 417 S.W.2d at 153 (quoting 54 C.J.S. *Limitations of Actions* § 168). In applying these principles to the facts of that case, the court wrote:

> [W]e have concluded that the plaintiff's cause of action did not arise until the tax deficiency was assessed by the Commissioner of Internal Revenue. Prior to assessments the plaintiff had not been injured. That is, assessment was the factor essential to consummate the wrong – only then was the tort complained of completed. If a deficiency had never been assessed, the plaintiff would not have been harmed and therefore would have had no cause of action. Thus, the use of the cash method, as opposed to the accrual method, was not in itself the type of unlawful act which, upon its commission, would set the statute in motion. In short, in the absence of assessment, injury would not have inevitably resulted.

Atkins, 417 S.W.2d at 153.

On original submission we held that appellees' cause of action did not accrue until assessments were issued to them by the IRS. Although these assessments were issued over a period of time, they were all issued within two years before suit was filed. This holding was based on the opinion in *Atkins*, the lack of finality in the IRS notices of

deficiency, and the other cases discussing the accrual of negligence causes of action.

On December 11, 1997, our supreme court issued its opinion in *Murphy v. Campbell*, 41 Tex.Sup.Ct.J. 193, No. 96-0079 (December 11, 1997) (rehearing pending).[3] In that five to four decision, the court held that "[a] person suffers legal injury from faulty professional advice when the advice is taken." *Id.* It also held that the discovery rule could, and in such cases often would, delay the accrual until the plaintiff knew or in the exercise of reasonable diligence should have known of the wrongful act and resulting injury. *Id.* In tax accounting malpractice cases like *Murphy*, the court held that a claimant's discovery of his injury "cannot occur later than the receipt of the [IRS] deficiency notice [ ]." *Id.* The court disposed of the conflicting language in *Atkins* by stating that, although the opinion said an accounting malpractice claim accrues when the IRS issues an assessment, it "did not mean the final assessment but rather, the earlier deficiency notice." *Id.*

As an intermediate appellate court we must, of course, apply the law as stated by our state supreme court. The difficulties that might arise in applying the court's new rule are not present in this case and therefore do not merit discussion here. The question now before us is when the appellee limited partners in Granada 4 knew or in the exercise of reasonable diligence should have

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[3] Parenthetically, it is worth noting that appellant Deloitte and Touche was a defendant in *Murphy*.

known of the wrongful act and their injury. More specifically, did the notices of deficiency sent to Granada on May 7, 1990, and received by GMC on May 12, 1990, commence the limitations period or did the discovery rule preclude accrual of appellees' cause of action until they were notified by GMC after May 30, 1990?

It is Deloitte's position that appellees' cause of action could not have accrued later than the date notice of deficiency was mailed to the "tax matters partner," GMC. This argument is premised on Deloitte's belief that notice to GMC is imputed to each of the limited partners. In support, Deloitte cites section 6226 of the tax code for the proposition that the date an FPAA is sent to a tax matters partner commences the limitations period for challenges by both the partnership and individual partners. 26 U.S.C. 6226. It also cites one sentence from a congressional report concerning tax code section 6223 in support of its position that "notice to a tax matters partner is treated as notice to [the individual] partners." H.R. Conf. Rep. No. 97-760, 97th Cong., 2d Sess. at 601, reprinted in 1982 U.S.C.C.A.N. 1190, 1373 (1982).

There are two reasons why Deloitte's arguments are unpersuasive. First, the cited tax code provisions address the procedural aspects of disputes between taxpayers and the IRS. They have no applicability to a state law tort action between taxpayers and third parties. Regardless of the degree to which the substantive legal issues in this case depend on federal tax law, they arise in the context of a tort action in state court and procedural issues, such as limitations, must be resolved pursuant to state law. *See e.g., Bell v. Showa Denko K.K.*, 899 S.W.2d 749, 757

(Tex.App. – Amarillo 1995, writ denied). Moreover, contrary to Deloitte's assertions, the tax code does not impute notice given to tax matters partners to limited partners. The code is clearly designated to provide partners with actual notice of IRS actions. Section 6223(a) of the tax code directs the IRS to send notice of an FPAA to each member of a partnership individually, unless there are more than 100 partners and the individual partner owns less than one percent interest in partnership profits. 26 U.S.C. § 6223(a). In the event there are more than 100 partners, the tax matters partner is specifically directed to keep the individual partners informed of IRS proceedings by virtue of section 6223(g).[4]

In order to decide when the plaintiffs' claims accrued under the discovery rule, we must determine whether knowledge by a general partner can be imputed to limited partners for purposes of the discovery rule. Appellees have failed to cite any authority holding that a party's knowledge of his injury cannot be imputed. Two cases support the position that such knowledge can be imputed. In *Willis v. Maverick*, 760 S.W.2d 642 (Tex. 1988), and in applying the discovery rule to legal malpractice claims, our supreme court noted the unfairness of beginning the limitations period for such actions "notwithstanding [ ] the lack of knowledge, actual or *constructive*, on the part of the client." (emphasis added). *Id.* at 646. Thus, by its comment, the court recognized the possibility of imputed knowledge. In *Knowlton v. U.S. Brass Corp.*,

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[4] The portion of the congressional report cited by Deloitte was the last sentence in a paragraph outlining the actual notice provisions of section 6223.

864 S.W.2d 585 (Tex.App. – Dallas 1993), reversed on other grounds, *Amsadt v. U.S. Brass Corp.*, 919 S.W.2d 644 (Tex. 1996), the defendant, a manufacturer of residential plumbing, argued that the plaintiff homeowners' claims were barred by limitations, and those plaintiffs could not rely on the discovery rule because the knowledge of the prior owners of the homes was imputed to them. 864 S.W.2d at 606. The court of appeals in its discussion assumed that knowledge could be imputed for purposes of the discovery rule, but declined to do so based on a lack of privity between the plaintiffs and the prior owners. *Id.* Disagreeing, the supreme court held that there was privity between the plaintiffs and prior owners and that the claims were barred on the basis of *res judicata*. 919 S.W.2d at 653. Consequently, it did not address the limitations issue or the court of appeal's assumption that knowledge could be imputed. These holdings, relating to consideration of imputed knowledge in determining the applicability of the discovery rule, are consistent with those of other jurisdictions. *See also Bennett v. Johnson*, 485 N.W.2d 481, 483 (Iowa App. 1992), and *Gilbert v. Sacred Heart Medical Ctr.*, 900 P.2d 552, 553-54 (Wash. 1995) (both holding that knowledge can be imputed for purposes of the discovery rule). *But see BASF Corp. v. Symington*, 512 N.W.2d 692, 697 (N.D. 1994) (knowledge of parent may not be imputed to minor plaintiff).

Thus, having determined that knowledge of an injury for purposes of the discovery rule can be constructive, we must next determine whether the existence of a limited partnership is sufficient to impute the knowledge of a general partner to the limited partners.

It has long been the rule that knowledge of a partner is imputed to the partnership. This rule has been statutorily recognized in Section 12 of the Texas Uniform Partnership Act. Tex. Rev. Civ. Stat. Ann. art. 6132b (Vernon 1970 & Supp. 1998).[5] Here, however, suit was not brought by the partnership but by the limited partners individually. Consequently, the rule imputing knowledge of a partner to a partnership is inapplicable.

Deloitte fails to cite any Texas case holding that notice to one partner is imputed to each of the other partners individually. It does cite *Wakefield v. Bevly*, 704 S.W.2d 339 (Tex.App. – Corpus Christi 1985, no writ), as support for the statement in its motion for rehearing that "notice to one partner will commence the limitations period in a suit by all partners." We do not agree the decision supports that statement. The *Wakefield* court merely applied the rule noted above that "[n]otice to any partner [ ] is notice *to the partnership*." *Id.* at 346 (emphasis added).

In *Avinger v. Campbell*, 499 S.W.2d 698 (Tex.Civ.App. – Dallas 1973), *writ ref'd n.r.e. per curiam*, 505 S.W.2d 788 (Tex. 1974), the Dallas Court of Appeals held that notice to some partners would not be notice to other partners. 505 S.W.2d at 703. However, that case is different from the one before us because it involved the imputation of one limited partner's knowledge to another limited partner.

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[5] Because the Texas Revised Limited Partnership Act does not specifically address this question, the Texas Uniform Partnership Act is applicable. Tex. Rev. Civ. Stat. Ann. art. 6132a-1, § 13.03 (Vernon Supp. 1998).

Parenthetically, the Dallas court failed to cite authority for that holding.

Offering some support for Deloitte's position are *Napper v. Johnson*, 464 S.W.2d 496 (Tex.Civ.App. – Waco 1971, writ ref'd n.r.e.), and *Gaynier v. Ginsberg*, 715 S.W.2d 749 (Tex. App. – Dallas 1986, writ ref'd n.r.e.). In *Napper*, a homeowner sought the advice of an attorney named Pritchard in an effort to avoid foreclosure on his home. Pritchard prepared a deed transferring the property to another of Pritchard's clients, Johnson, in exchange for $15,000 and an option to repurchase the property within six months. Pritchard then paid Johnson for a half interest in the property. The question before the Waco court was whether Johnson knew that the homeowner intended the instrument to be a mortgage rather than a deed. In holding that Johnson knew or should have known of the homeowner's intent, the court implied a partnership between Pritchard and Johnson and based on that partnership reasoned that "Pritchard's knowledge is binding on Johnson" 464 S.W.2d at 498.

However, several differences in the facts before the *Napper* court and those before us persuade us that the holding of that case does not conclusively resolve the issue before us. First, similar to the failure of *Avinger* to do so, the *Napper* court cites no authority in support of the cited proposition. Second, since Pritchard was Johnson's attorney, and therefore his agent, the opinion's result was supportable on the well established rule that a principal is charged with the knowledge of his agent. *See, Farmer Enterprises, Inc. v. Gulf States Ins. Co.*, 940 S.W.2d 103, 111 (Tex.App. – Dallas 1996, no writ); Restatement (Second) of Agency, § 268. Third, there was evidence that

Johnson had actual knowledge of the homeowner's intent. 464 S.W.2d at 498.

As did the facts in *Napper*, the *Gaynier* case also involved the obligations flowing from an attorney to his client. The attorney/defendant in *Gaynier* was denied a summary judgment based on his professional relationship with the plaintiff, in extending the denial of summary judgment to the other participants in a joint venture in which the attorney was involved, the court held that joint venturers are charged with the knowledge of their co-venturer. In doing so, the court relied on *Napper* and *Dial Temp Air Cond. Co. v. Faulhaber*, 340 S.W.2d 82 (Tex.Civ.App. – Dallas 1960, writ ref'd n.r.e.). As with *Napper*, the party with actual knowledge was also acting in the role of attorney for the joint venture. Parenthetically, *Dial Temp* merely held that an attorney's knowledge is imputed to their client. *Id.* at 87.

Because the parties to whom Deloitte seeks to have GMC's knowledge imputed are limited partners, the facts in the *Avinger* case are more closely analogous to the facts before us than are those in either the *Napper* or *Gaynier* cases. In *Avinger*, however, the parties with actual knowledge were other limited partners. Here, of course, the party with actual knowledge, GMC, was the sole general partner. Because of the indicated uncertainty of Texas law of this issue, and the fact that both the Texas Revised Limited Partnership Act[6] and Texas Uniform Partnership

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[6] Tex. Rev. Civ. Stat. Ann. art. 6132a-1, § 13.01(a)(b) (Vernon Supp. 1998)

Act[7] are uniform acts and should be construed to make uniform the law of those states enacting similar provisions, we must consider the decisions by the courts of other jurisdictions.

We have discovered four cases in which courts have held that the knowledge of one partner is imputed to the other partners. They are: *BMS Partnership v. Winter Park*, 910 P.2d 61 (Colo.Ct.App. 1995); *South Union v. George Parker & Assoc.*, 504 N.E.2d 1131 (Ohio App. 1985); *Lee v. Durango Music*, 355 P.2d 1083 (Colo. 1960); and *Stork Restaurant v. Sahati*, 166 F.2d 348 (9th Cir. 1948). None of those cases involved the discovery rule and most involved general partnerships. For example, *Lee* involved two general partners who were also spouses. 355 P.2d at 1086. Only *BMS Partnership* involved a limited partnership. The Colorado Court of Appeals held that the knowledge of a general partner is imputed to the limited partners. 910 P.2d at 63.

The defining characteristic of a limited partner is the lack of participation in the management or control of the partnership. Tex. Rev. Civ. Stat. Ann. art 6132a-1, § 3.03 (Vernon Supp. 1998). Even though that lack of participation in partnership management raises some question about the fundamental fairness of imputing the knowledge of general partners to limited partners, the weight of authority is to impute that knowledge. Thus, the authority discussed above persuades us that limited partners are deemed to know the facts known by the general partners. That being so, appellees are charged with

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[7] Tex. Rev. Civ. Stat. Ann. art. 6132b, § 4(4) (Vernon 1970).

knowledge of the IRS FPAA on the date it was received by the general partner, GMC. That knowledge stopped the delaying effect of the discovery rule. Thus, because that date was more than two years before suit was filed, the action is time barred and we must sustain Deloitte's first point.

Accordingly, the judgment of the trial court is reversed and judgment rendered that appellees take nothing by their suit. Tex. R. App. P. 43.2(c).

John T. Boyd
Chief Justice

Publish.

APPENDIX 3

(SEAL) **THE SUPREME COURT OF TEXAS**
Post Office Box 12248
Austin, Texas 78711 (512) 463-1512

October 29, 1998

Mr. David J. Beck
Beck Redden & Secrest
1221 McKinney Street, Suite 4500
Houston, Tx 77010-2010

Mr. Geoffrey L. Harrison
Susman Godfrey
1000 Louisiana, Suite 5100
Houston, TX 77002-5096

Ms. Julie Caruthers Parsley
Thompson & Knight
98 San Jacinto Blvd., Suite 1200
Austin, TX 78701-4081

RE: Case Number 97-1012
Court of Appeals Number: 07-96-00324-CV
Trial Court Number: 92-023452

Style: DELOITTE & TOUCHE
v.
HARVILL E. WELLER, JR. and FREDERICK B. WOOKEY, JR.

Dear Counsel:

Today, the Supreme Court of Texas denied the petition for review in the above styled case.

Motion to dismiss is dismissed as moot.

Sincerely,

John T. Adams, Clerk

by /s/ Blanca E. Morin
Blanca E. Morin,
Deputy

cc: Peggy Culp, Clerk
Mr. Charles Bacarisse

APPENDIX 4

(SEAL) **THE SUPREME COURT OF TEXAS**
Post Office Box 12248
Austin, Texas 78711 (512) 463-1512

January 07, 1999

Mr. David J. Beck
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Austin, TX 78701-4081

RE: Case Number 97-1012
Court of Appeals Number: 07-96-00324-CV
Trial Court Number: 92-023452

Style: DELOITTE & TOUCHE
v.
HARVILL E. WELLER, JR. and FREDERICK B. WOOKEY, JR.

Dear Counsel:

Today, the Supreme Court of Texas overruled the motion for rehearing in the above styled petition for review.

Sincerely,

John T. Adams, Clerk

by /s/ Matthew D. Melton
Matthew D. Melton,
Deputy

cc: Peggy Culp, Clerk
Mr. Charles Bacarisse

APPENDIX 5

NO. 97-1012

IN THE
SUPREME COURT
FOR THE STATE OF TEXAS

HARVILL E. WELLER, JR. and
FREDERICK B. WOOKEY, JR.,

Petitioners,

v.

DELOITTE & TOUCHE,

Respondent.

On Appeal from the Seventh Court of Appeals
at Amarillo, Texas

PETITIONERS' MOTION FOR REHEARING

TO THE HONORABLE SUPREME COURT OF TEXAS:

Preliminary Statement

On June 8, 1998, Plaintiffs filed their Petition for Review of an Amarillo court of appeals decision that reversed a $79 million judgment in favor of a class of 10,358 members based upon this Court's decision in *Murphy v. Campbell*, 964 S.W.2d 265 (Tex. 1997). On October 29, 1998, this Court denied the Petition for Review.

Accordingly, Plaintiffs file this Motion for Rehearing to request that the *Murphy* opinion not be applied retroactively to bar their claims.

Argument

It is well-established that this Court has discretion to apply its decisions prospectively only, particularly where, as here, a new principle of law that was not clearly foreshadowed results in substantial unfairness to a litigant. *See, e.g., Carrollton-Farmers Branch Indep. Sch. Dist. v. Edgewood Indep. Sch. Dist.*, 826 S.W.2d 489 (Tex. 1992); *see also Edgewood Indep. Sch. Dist. v. Meno*, 917 S.W.2d 717, 726 (Tex. 1995) ("This Court's role . . . should be one of restraint"). Indeed, the United States Supreme Court has held that:

> [J]udge-made rules of law are *hard facts* on which people must rely in making decisions and in shaping their conduct. This fact of legal life underpins our modern decisions recognizing a doctrine of nonretroactivity.

Lemon v. Kurtzman, 411 U.S. 192, 199 (1973) (emphasis added).

In *Atkins v. Crosland*, 417 S.W.2d 150 (Tex. 1967), this Court held that:

> [T]he plaintiff's cause of action did not arise until the tax deficiency was assessed by the Commissioner of Internal Revenue. Prior to assessment the Plaintiff had not been injured. That is, assessment was the factor essential to consummate the wrong – only then was the tort complained of completed. If a deficiency had never been assessed, the plaintiff would not

> have been harmed and therefore would have had no cause of action.

Id. at 153. This Court attempts to distance itself from *Atkins'* clear holding by stating that "[a]lthough we referred in [*Atkins*] to the IRS's 'assessment' . . . we did not *mean* the final assessment but rather, the earlier deficiency notice." *Murphy* at 271. Whatever the Court may have *meant*, the actual words used by the Court in *Atkins* were unequivocal and clearly defined the law in Texas for thirty years. Retroactive application of *Murphy* because of what the Court might have *meant* in *Atkins*, rather than what it actually *said*, would indeed make for an unfortunate footnote in this State's history of jurisprudence. Indeed, shortly after the *Murphy* decision, this Court again opined that:

> *Atkins* involved a suit by a taxpayer against his accountant for negligence. We held that the statute of limitations did not begin to run against the taxpayer in that case until his tax deficiency was assessed by the IRS because "prior to assessment the plaintiff had not been injured."

Johnson & Higgins of Texas, Inc. v. Kenneco Energy, Inc., 962 S.W.2d 507, 515 (Tex. 1998). Likewise, the Amarillo court of appeals in its first decision prior to this Court's opinion in *Murphy*, applied *Atkins* to hold that the plaintiff class' limitations period in this case accrued at assessment, not at the earlier FPAA, which Deloitte argued was a *Murphy* notice of deficiency. Slip Opinion at 9.

This Court's *Murphy* decision was a significant change in the law that could not have been predicted under any standard of fairness. For thirty years, *Atkins* defined the accrual date for accounting malpractice

claims in Texas. The Plaintiff class and the Honorable Scott A. Brister, the judge at trial, relied upon the clear language from *Atkins* to determine when limitations had accrued.[1] Plaintiffs should not be penalized for their reliance on what was at the time well-settled law, particularly where, as here, the suit was filed only two years and *fourteen days* after the general partner received an ambiguous FPAA from the IRS, but less than two years from the date any class member actually received the FPAA and the general partner's "cover up" letter. For these reasons and for the reasons set forth in the Petition for Review, Plaintiffs respectfully request that the Court reconsider its denial of their Petition for Review and order that *Murphy* not be applied retroactively to bar their claims.[2]

Prayer

Petitioners, Harvill E. Weller, Jr. and Fredrick B. Wookey, Jr., on behalf of the plaintiff class, respectfully request that this Honorable Court reconsider its denial of

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[1] Relying on *Atkins* and its progeny, Judge Brister ordered that actual damages be proved to the penny in a detailed claims procedure that required contact with and sworn evidence from 7,808 limited partner class members, a procedure that cost Plaintiffs' counsel over $600,000. This could be the reason, at least in part, for the Amarillo court's concern about the "fundamental [un]fairness" of applying the *Murphy* decision to this case. Slip Opinion at 16.

[2] Curiously, this is not the first time Deloitte & Touche has sought the retroactive application of a new and shorter limitations period to escape liability. *See Ades v. Deloitte & Touche*, 799 F. Supp. 1493 (S.D.N.Y. 1992).

Plaintiffs' Petition for Review, reverse the judgment of the court of appeals and remand this case to the court of appeals for consideration of the points not decided by that court.

Respectfully submitted,

SUSMAN GODFREY L.L.P.

By: /s/ Gregory N. Jones
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Attorneys for Petitioners Harvill E. Weller, Jr., and Frederick B. Wookey, Jr.

CERTIFICATE OF SERVICE

This is to certify that on November 11th, 1998, a true and correct copy of the above foregoing instrument was properly forwarded to the following counsel of record in accordance with Rule 21 of the Texas Rules of Civil Procedure as indicated below:

Robert M. Corn WOODARD, HALL & PRIMM 600 Travis Street, Suite 7000 Houston, Texas 77002	*Via Hand Delivery*
David J. Beck BECK, REDDEN & SECREST 1221 McKinney, Suite 4500 Houston, Texas 77010-2002	*Via Hand Delivery*
John T. Behrendt GIBSON, DUNN & CRUTCHER 200 Park Avenue New York, New York 10166-0193	*Via Certified Mail – RRR*
Theodore B. Olson GIBSON, DUNN & CRUTCHER 1050 Connecticut Avenue, N.W. Washington, D.C. 20036	*Via Certified Mail – RRR*
Charles R. Watson, Jr. CARR, FOUTS, HUNT & WOLFE, L.L.P. 500 S. Taylor St., Suite 207 Amarillo, Texas 79101	*Via Certified Mail – RRR*

/s/ Gregory N. Jones
Gregory N. Jones